In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	
MULBERRY CHESTERTON INN, L.P.	)	Adversary Proceeding
(Chapter 11 Case 90-40459)	)	Number 91-4020
	)	
Debtor	)	
	)	
	)	
	)	
DAYS INN OF AMERICA, INC.	)	
	)	
Plaintiff	)	
	)	
	)	
v.	)	
	)	
CITIZENS AND SOUTHERN TRUST COMPANY (GEORGIA) NATIONAL ASSOCIATION; BANK SOUTH, N.A.; and MULBERRY CHESTERTON INN, L.P.	)	
	)	
Defendants	)	

MEMORANDUM AND ORDER

Days Inns of America, Inc. (hereinafter "DIA") filed this adversary proceeding to determine its right to subrogation under 11 U.S.C. Section 509. According to DIA, it is entitled to be subrogated to the rights of Citizens and Southern Trust Company (Georgia) National Association (hereinafter "C&S") to the extent of $944,071.76, the

amount DIA paid to C&S pursuant to a guaranty. DIA argues that it should be subrogated to C&S's secured claim, which has priority over the claims of Bank South, a Defendant in this adversary proceeding.

This case is before the court on DIA's Motion for Partial Summary Judgment and Bank South's Motion for Summary Judgment. Upon consideration of the briefs and other documentation submitted by the parties, I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

In 1981, the Savannah Port Authority issued $5,000,000.00 in revenue bonds, designated the "Savannah Port Authority Industrial Development Revenue Bonds (Mulberry Partnership Project) Series 1981" (hereinafter "the 1981 bonds"). These bonds were issued pursuant to an Indenture of Trust between SPA and Atlantic Bank and Trust Company, the indenture trustee, dated June 1, 1981 (the indenture). *See* Document 15, Exhibit 2.[1] The SPA loaned the proceeds from the bond sale to an entity known as The Mulberry Partnership, pursuant to a bond loan agreement dated June 1, 1981. *See* Document 15, Exhibit 1.

The Mulberry Partnership, a limited partnership consisting of DIA as

[1] DIA filed copies of the relevant guaranty agreement, loan agreements, indentures, and security agreements. *See* Document 15, Request for Admissions to Bank South, N.A., and Mulberry Chesterton Inn, L.P., with the attached Exhibits 1 - 21, filed on June 26, 1991.

general partner and Mulberry Employees Partnership, a limited partner, used the bond proceeds to acquire and restore the Mulberry Inn, a luxury hotel located in Savannah's historic district near the noted Pirates' House Restaurant. The "Mulberry Partnership Project" was the first attempt of the Days Inns chain to enter the luxury hotel market.

To secure the bond loan, Mulberry Partnership granted Atlantic Bank, the indenture trustee, a first priority deed to secure debt and security interest in the Mulberry Inn realty, equipment, assets, related personal property, and the income generated by the inn. The security was evidenced by the Deed to Secure Debt and Security Agreement between Mulberry Partnership and Atlantic Bank dated June 1, 1981. *See* Document 15, Exhibit 3. Additionally, the SPA granted Atlantic Bank a security interest in the bond loan agreement to secure SPA's obligations under the indenture. SPA is obligated to the bond holders to pay the principal, premium, and interest deposited into the bond fund by Mulberry Partnership and now the Debtor, which assumed the obligations of Mulberry Partnership. Additional security for the bond loan was provided by Cecil B. Day Companies which unconditionally guaranteed payment of the amounts due to the bondholders and the performance of SPA under the indenture. Cecil B. Day Companies became obligated as guarantor of the bonds under the guaranty agreement between Cecil B. Day Companies, Inc., and Atlantic Bank dated June 1, 1981.[2] *See* Document 15, Exhibit 4.

In 1983, the SPA issued an additional $1,000,000.00 in revenue bonds designated "Savannah Port Authority Industrial Development Revenue Bonds (Mulberry

[2] Cecil B. Day Companies, Inc., was the parent corporation of DIA. Cecil B. Day Companies, Inc., changed its name to CBD Enterprises, Inc., and later merged into DIA, the Plaintiff in this adversary proceeding. DIA as successor corporation to Cecil B. Day Companies, Inc., claims to be entitled to subrogation pursuant to this guaranty agreement.

Partnership Project) Series 1983" (hereinafter "the 1983 bonds"). The 1983 bonds were secured on a parity basis under the indenture and bond security deed with the 1981 bonds. The indenture, bond loan agreement, bond security deed, and the guaranty were amended in connection with the new bond issue.[3] *See* Document 15, Exhibits 11, 12 and 13.

In December 1984, Bank South, Atlantic Bank's successor by merger, resigned as trustee under the indenture and was replaced by Citizens and Southern Trust Company (Georgia) National Association. In connection with its resignation, Bank South assigned all of its right, title and interest in and to the bond security deed to C&S pursuant to an Assignment of Deed to Secure Debt and Security Agreement executed by Bank South and dated December 6, 1984. *See* Document 15, Exhibit 17. To facilitate Mulberry Partnership's sale of the Mulberry Inn to Mulberry Inn, Inc., SPA and C&S entered into a second supplemental indenture of trust dated September 1, 1984.[4] *See* Document 15, Exhibit 14. Under this agreement, the 1983 bonds were redeemed and the First Supplemental Indenture was discharged. Additionally, the SPA and Mulberry Partnership entered into a Second Amendment to Loan Agreement dated September 1, 1984, which limited the liability of the entity purchasing the Mulberry Inn to its interest in the Mulberry Project, the agreement, and the mortgage. *See* Document 15, Exhibit 15. As security, Mulberry Partnership agreed to remain liable under the loan agreement and security deed. Cecil B. Day Companies, the guarantor, agreed that the guaranty would remain in full force notwithstanding the sale of the property. These promises and the signatures of the

[3] The 1983 bonds were later fully redeemed.

[4] The second Supplemental Indenture between SPA and C&S is dated September 1, 1984, before Bank South transferred its interest as trustee and successor by merger to C&S. On the indenture it shows that Bank South consented to the indenture in December of 1984 upon the final sale and assignment. Therefore, the indenture entered into by C&S is correctly dated before the actual assignment to C&S.

representatives of Mulberry Partnership and Cecil B. Day Companies are found in the Second Amendment to Loan Agreement.

On February 1, 1985, SPA, C&S and Mulberry Partnership entered into a Third Supplemental Indenture of Trust and Second Amendment to Deed to Secure Debt and Security Agreement. *See* Document 15, Exhibit 18. This supplemental indenture specifically granted subrogation rights to "Mulberry Partnership, Days Inns of America, Inc. (as general partner of Mulberry Partnership) or the Guarantor" and provided for the release of C&S upon full payment of the bond debt. "Guarantor" in this indenture refers to Cecil B. Day Companies, Inc., and is defined in the original loan agreement as

> (i) Cecil B. Day Companies, Inc., a Georgia Corporation, and its successors and assigns, and (ii) any surviving, resulting or transferred entity as provided in the Guaranty.

(See Document 15, Exhibit 1, the original loan agreement between Savannah Port Authority and Mulberry Partnership dated June 1, 1981.) Also, SPA and Mulberry Partnership entered into the Third Amendment to Loan Agreement dated February 1, 1985. *See* Document 15, Exhibit 19. This amendment specified Mulberry Inn, Inc.'s limited liability by which Mulberry Inn, Inc. "agrees to assume the obligations of Mulberry Partnership under the Agreement, as amended by the First Amendment and Section 11.12 hereof." Under the amended Section 11.12, Mulberry Inn, Inc., agreed only to non-recourse liability.

Also, in the Third Amendment to Loan Agreement, Mulberry Partnership agreed to remain primarily liable under the bond loan agreement and the Security Deed. The

guarantor, Cecil B. Day Companies, agreed that the guaranty would remain in full force and effect notwithstanding the sale of the property. A C&S representative also signed and consented to the amended loan agreement. Mulberry Inn, Inc.'s acquisition of the Mulberry Inn was financed by a loan of $4,100,000.00 from Bank South. Mulberry Inn, Inc.'s obligations to Bank South were secured by a security deed to and a security interest in the inn, which was second in priority and subordinate to the security deed and security interest held by C&S, which had expressly retained the liability of the original obligors and granted subrogation rights to them in the event of payment.

Subsequently, Mulberry Inn, Inc., conveyed all of its interest in the Mulberry Inn to Mulberry Inn, Ltd. After the sale to Mulberry Inn, Ltd., both Mulberry Inn, Ltd., and Mulberry Inn, Inc., defaulted on the debt owed to Bank South. Shortly after the default, Bank South purchased the property subject to the Bond Security Deed in favor of C&S; the property was acquired at an advertised sale conducted under a power of sale on February 2, 1988.

In June, 1988, Bank South sold the Mulberry Inn to the Debtor, Mulberry Chesterton Inn, L.P., subject to the security deed in favor of C&S. In connection with the sale, the Debtor agreed to assume all of the obligations of the original borrower, Mulberry Partnership, under the Bond Loan Agreement. This agreement was evidenced by the Assumption Agreement of June 30, 1988, signed by the Debtor and acknowledged by Bank South and C&S. *See* Exhibit 22 attached to the Second Request for Admissions to Bank South, N.A., and Mulberry Chesterton Inn, L.P., filed by DIA on June 11, 1991.

Additionally, the guarantor affirmed its obligations under the original guaranty pursuant to the confirmation of guaranty executed by CBD Enterprises, Inc., formerly Cecil B. Day Companies, Inc., dated June 30, 1988.[5] Debtor's acquisition of the inn was financed by a loan from Bank South of $4,080,000.00. The Debtor executed a deed to secure debt and security agreement granting Bank South a security interest and security deed to the inn, including income from the real and personal property. The Debtor also entered into an Assignment of Leases and Rents in favor of Bank South. Bank South's security interest is second in priority and subordinate to C&S's security under the bond security deed. As of February 21, 1991, Debtor owed $4,306,096.67 in principal and interest to Bank South with interest accruing at the per diem rate of $1,060.04[6] according to the Stipulation of Facts filed in this adversary proceeding.

In June, 1989, Debtor defaulted in its bond loan obligations by failing to make its June payment of principal and interest. C&S informed DIA that Debtor defaulted on its debt service payment due June 1, 1989, and made a demand for payment. On July 14, 1989, DIA paid $432,147.61 to C&S by wire transfer. In December, 1989, Debtor again defaulted by failing to pay its December installment of interest only. On December 11, 1989, DIA made another payment to C&S in the amount of $214,783.46. *See* Stipulation of Facts.

On February 8, 1990, approximately two months after DIA's second

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[5] *See* Footnote 1.

[6] Additionally, the Debtor owes Bank South for a vehicle which is a separate debt not reflected in the amounts owed for the purchase of the Mulberry Inn.

payment guaranteeing the bonds, the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Venue was transferred from New York, where the case was originally filed, to this Court by order dated March 8, 1990.

Subsequent to the bankruptcy filing, C&S made an additional demand for payment on June 1, 1990. Although prior demand letters were not made part of the record, the demand letter of June 1, 1990, was filed with the Court and attached to the Affidavit of Douglas Collins, Senior Vice President and Chief Financial Officer of Days Inns of America, Inc. The demand letter was addressed to Mr. James E. Cutler, Chief Financial Officer, CBD Enterprises, Inc., c/o Days Inns, Inc. The demand letter of June 5, 1991, also attached to the affidavit, was addressed the same way. Both letters state that

> [P]ursuant to Section 2.1 of the Guaranty Agreement (the "Guaranty") dated as of June 1, 1981, by and between the Trustee and CBD Enterprises, Inc., formerly known as Cecil B. Day Companies, Inc. (the "Guarantor") the Trustee hereby delivers to you a demand for payment under the Guaranty . . .

See Exhibits 23 and 24 attached to the Affidavit of Douglas Collins filed September 12, 1991. Although the parties failed to specify when Cecil B. Day Companies, later CBD Enterprises, Inc., merged with DIA, the parties stipulate that C&S made demand on DIA and that DIA paid the sums requested. DIA transferred the sum of $297,140.69 to C&S by wire transfer on June 11, 1990, in response to the June 1st demand. The parties stipulated that $3,825,000.00 is owed to C&S under the documents evidencing the original bond issue, after Debtor's June, 1991, interest payment. Amounts due after June 1991 are not considered in this Order.

On February 19, 1991, DIA instituted this adversary proceeding by filing its Complaint to Determine Validity, Priority and Extent of Lien and Subrogation Rights Under 11 U.S.C. Section 509. DIA alleged that it paid a total of $944,071.76 to C&S pursuant to its guaranty and contends that it should be subrogated to C&S, including C&S's rights as a secured creditor under the bond security deed.

C&S filed a Motion to Dismiss or, in the Alternative, to Sever Issues and Stay Proceedings. Pursuant to a Consent Order, C&S was dismissed from the above-styled adversary without prejudice. Bank South filed an Answer to DIA's complaint, alleging that Bank South's lien and security should have priority over DIA's asserted lien and over all other liens against the Debtor with the exception of C&S's first priority lien. Additionally, Bank South argues that DIA does not meet the requirements for subrogation under Section 509 of the Bankruptcy Code and is not entitled to relief under that section. On March 29, 1991, the Debtor filed its Answer and Counterclaim, alleging that DIA did not guarantee a debt of the Debtor and that DIA has no valid claim against the Debtor. This adversary proceeding is before the Court on DIA's Motion for Partial Summary Judgment on the issue of subrogation under Section 509 of the Bankruptcy Code. Bank South also filed a Motion for Summary Judgment. As both parties have moved for summary judgment, my decision will be based on the briefs, authorities, and other documentation submitted by the parties.

CONCLUSIONS OF LAW

DIA premises its claim for subrogation in its capacity as a guarantor and as

a general partner in the Mulberry Partnership upon 11 U.S.C. Section 509. Cecil B. Day Companies, Inc., which later merged into DIA, signed a guaranty agreement guaranteeing the debt for the 1981 bonds issued by the Savannah Port Authority. In addition, DIA was the general partner in the Mulberry Partnership, a limited partnership, the principal obligor on the original loan agreement with SPA. DIA argues that it is an entity liable with the Debtor under Section 509 because of the guaranty agreement as well as its general partnership in and derivative liability through Mulberry Partnership.

I. DIA as Guarantor under the Guaranty Agreement.

A. DIA as Guarantor of the Debtor under 11 U.S.C. Section 509(a).

DIA argues that it is a guarantor of the Debtor under the guaranty agreement pursuant to 11 U.S.C. Section 509(a). Section 509(a) provides:

> Except as provided in subsection (b) or (c) of this section, an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment.

11 U.S.C. §509(a). The purpose of subrogation is to prevent unearned enrichment of a party at the expense of another. Compania Anonima Venezolana De Navegacion v. A. J. Perez Export Co., 303 F.2d 692, 697 (5th Cir. 1962), cert. denied 371 U.S. 942, 83 S.Ct. 321, 9 L.Ed.2d 276 (1962). The doctrine of subrogation is based on the equitable notion that "one who has been compelled to pay a debt which ought to have been paid by another is entitled to exercise all the remedies which the creditor possessed against that other." American Surety Co. v. Bethlehem National Bank, 314 U.S. 314, 317, 62 S.Ct. 226, 228, 86 L.Ed. 241

(1941) (citations omitted). *See* Matter of Bugos, 760 F.2d 731 (7th Cir. 1985). One who pays the debt for another should be entitled to the secured status and priority ranking of the secured creditor who was paid. In re Wingspread Corp., 116 B.R. 915 (Bankr. S.D.N.Y. 1990). In re Miller, 72 B.R. 352 (Bankr. W.D.Pa. 1987); In re Chasey, 16 B.R. 347 (Bankr. W.D.N.Y. 1982).

Bankruptcy Code Section 509 can be used by co-debtors, guarantors, sureties and others who are liable with the debtor and actually pay the debtor's debt. *See* In re Trasks' Charlois, 84 B.R. 646, 648 (Bankr. D.S.D. 1988). A party seeking subrogation under Section 509 is not required to be a guarantor or surety. In re Valley Vue Joint Venture, 123 B.R. 199 (Bankr. E.D.Va. 1991). The legislative history of Section 509 refers to subrogation as a means for co-debtors to enforce the right of contribution and indemnification. H.R.No. 95-595, 95th Cong., 1st Sess. 358-59 (1977); S.R. No. 95-989, 95th Cong., 2d Sess. 73-74 (1978), U.S.Code Cong. & Admin. News 1978, p.5787. This Code Section allows the party paying the debt to step into the shoes of the one paid. In re Derby Stores, Inc., 86 B.R. 768 (Bankr. S.D.N.Y. 1988).

Bank South's first argument is that Cecil B. Day Companies did not guarantee a debt or claim against the Debtor. Bank South argues that the debt paid by DIA (the successor by merger of Cecil B. Day Companies, Inc.) was the obligation of the issuer, SPA, and not a debt of the Debtor. DIA claims to be a guarantor of the Debtor under the original guaranty agreement between Cecil B. Day Companies, Inc., as guarantor and Atlantic Bank, the original indenture trustee.

A contract of guaranty exists where one lends his credit for the benefit of another, but under an obligation which is separate and distinct from that of the principal debtor, and where he renders himself secondarily or collaterally liable on account of any inability of the principal to perform his own contract. Graybar Electric Company, Inc. v. Opp., 138 Ga. App. 456, 226 SE2d 271 (1976); modified on other grounds, Graybar Electric Company, Inc., v. Opp, 140 Ga. App. 481, 231 SE2d 494 (1976). Accordingly, DIA argues that it was secondarily liable for the payment to the bondholders and was obligated to pay any principal and interest upon the default or failure of the Debtor to make payments into the bond fund.

The guaranty agreement provides in Section 2.1 that the guarantor unconditionally guarantees to the trustee "for the benefit of the bondholders" payment of principal and interest to the bondholders. Also, in this section the guarantor promises to pay such amounts "upon the failure of the issuer" to pay the bondholders. Apparently Bank South derives from this section, at least in part, its argument that Cecil B. Day Companies guaranteed SPA's liability on the bond debt and not the Debtor's. Although nothing else in the guaranty agreement specifically refers to the debt as that of SPA or the Debtor, the loan agreement refers to Cecil B. Day Companies as guarantor of the bond loan agreement. Other documents involved in the bond transaction, however, state that SPA's obligation is to be a limited obligation and not a general obligation. Under most circumstances an issuer of bonds is generally liable for the bonds it issues. However, a reading of all the relevant documents leads to the conclusion that all parties agreed that SPA was not generally liable for the bonds whereas, Cecil B. Day Companies as guarantor was to be fully liable for the entire bond debt not just SPA's limited obligation. Contrary to Bank South's assertions,

SPA's limited liability for the bond debt is relevant in interpreting the bond loan documents and determining DIA's right to subrogation.

The guaranty agreement is not one isolated agreement. The transaction of issuing the bonds and loaning the proceeds to Mulberry Partnership necessitated several inter-related documents. Although unified construction of documents is inappropriate unless each of the documents is executed by the same parties, that doctrine is not disturbed here where each subsequent document refers to and incorporates the rights, terms, and definitions established in the other documents.[7] In order to determine the rights of all the parties, the documents must be examined together. Such unified construction does not alter the legal character of the documents but is used here only to determine the existence and extent of the equitable right to subrogation under Section 509 of the Bankruptcy Code.

First, the loan agreement between SPA and Mulberry Partnership provides Mulberry Partnership's (and now the Debtor's) liability on the bonds. The agreement provides that Mulberry Partnership will be liable to SPA for all principal and interest on the bonds. The loan agreement in its definition section specifically refers to the guaranty agreement and to Cecil B. Day Companies, Inc., as guarantor of the bond debt. Under this

[7] In In re Martin Brothers Toolmakers, Inc., 796 F.2d 1435 (11th Cir. 1986), the debtor argued that an agreement constituted a mortgage in bankruptcy and not a lease as stated in the agreement. The debtor argued that its lease, the separate mortgage, and the assignment must be construed as one agreement for a mortgage, citing Hunter-Benn & Co. v. Bassett Lumber Co., 234 Ala. 215, 139 So. 348 (1932) for the theory that such documents should be read together as one agreement. The Eleventh Circuit rejected the debtor's claims concluding that the debtor bargained for and benefitted from a lease. The court refused to apply a unified construction of the documents and determined that the debtor should be bound to the agreement as a lease and not a mortgage. The court noted that a unified construction is appropriate when the documents are executed by the same parties. As the parties to the documents were different and the terms of the lease precluded debtor's interpretation of the documents, the court ruled against the debtor. Here a unified construction would not alter the legal character of the document but would clarify the intent of the parties regarding the equitable right to subrogation. As noted above each subsequent document refers to and incorporates the terms of the earlier documents, although the parties are not the same in each document. The facts and equitable considerations here distinguish this case from Martin Brothers, which is sufficiently different from this case so as not to preclude a unified construction.

loan agreement, the guarantor was to be liable for all principal and interest under the loan agreement as was Mulberry Partnership whereas SPA was limited in liability to the amounts it received from Mulberry Partnership or the Debtor.

Second, the indenture agreement between SPA and Atlantic Bank provides for the trustee, Atlantic Bank (and now its successor, C&S) to be responsible for the bond fund and the principal and interest payments from Mulberry Partnership on the account of the issuer. The indenture refers to the loan agreement and incorporates the definition section in Article I of that agreement. The definition section includes the definition of "guarantor" as Cecil B. Day Companies, Inc., a Georgia Corporation and its successors and assigns. In Section 2.03 of the Indenture, SPA and Atlantic Bank specifically agree that the issuer, SPA is not generally liable for the bonds or interest; the obligation is to be a limited obligation payable solely from the amounts pledged and payable under the loan agreement and other related proceeds and revenues. Section 5.01 of the indenture reiterates that the obligation is limited with payments to come from the proceeds of the loan agreement, the guaranty, and the mortgage but not from the issuer generally. The loan agreement together with the indenture provide that Mulberry Partnership and the guarantor are to be liable for repayment of the bond debt whereas SPA is not. Pursuant to the agreements SPA assigned the obligations of Mulberry Partnership contained in the loan agreement to Atlantic Bank. Atlantic Bank as assignee is the holder of an obligation of Mulberry Partnership, and that obligation is guaranteed by DIA's predecessor.

Third, the deed to secure debt and security agreement between Atlantic Bank and Mulberry Partnership grants Atlantic Bank, the trustee, as security for the bond

debt, an interest in the real estate, fixtures, equipment and personal property. Fourth, the guaranty agreement between Cecil B. Day Companies, Inc., and Atlantic Bank guarantees the bond debt.[8] Of course, other documents were involved in the bond issue and certain amendments followed, but these four documents, the guaranty, the loan agreement, the indenture, and the deed to secure debt and security agreement (the mortgage) established the rights and liabilities of the original parties involved in the bond issuance. Also, as noted in the Findings of Fact these documents were executed on the same day in what appears to be one multi-faceted transaction with the objective of loaning the bond proceeds to the Mulberry Partnership.

Additionally, the preliminary official statement and the official statement regarding the issuance of the bonds provided information to the public about the bonds and the parties involved. On the first page at the top of this announcement is the statement that the obligation of the issuer is to be a limited obligation and not a general obligation. According to this statement, the issuer, SPA, was to be obligated to remit to the bondholders the amounts received from the Mulberry Partnership, but the bond debt was not to constitute an "indebtedness" or pecuniary liability of the issuer. The statement goes on to specify that Cecil B. Day Companies, Inc., will unconditionally guarantee the bond debt to the bondholders. The guaranty by Cecil B. Day Companies, Inc., a well known and established company certainly made the debenture offer more attractive to investors which benefitted all parties, particularly Mulberry Partnership, the primary obligor under the bond loan agreement.

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[8] Despite the subsequent changes in ownership of the Mulberry Inn, Cecil B. Day Companies, Inc., later CBD Enterprises, Inc., and its successor DIA, continued to be bound by the original guaranty agreement as evidenced by the confirmation of guaranty dated June 30, 1988.

The Bankruptcy Court must look through form to substance when determining the true nature of a transaction. In re Bedford Computer Corp., 62 B.R. 555 (Bankr. D.N.H. 1986); Matter of Transystems, Inc., 569 F.2d 1364 (5th Cir. 1978). Viewing the bond issue and the loan agreement as one inter-related transaction, it is clear that the primary obligor on the bonds, SPA, was a mere conduit. The true obligor was Mulberry Partnership and it is clear that Cecil B. Day Companies guaranteed its bond debt and was obligated to pay Atlantic Bank if Mulberry Partnership (and its successor) defaulted in its payments to SPA under the loan agreement. There is no basis for holding that Cecil B. Day Companies guaranteed only SPA's debt and not Mulberry Partnership's debt on the bonds. The guaranty agreement required Cecil B. Day Companies, Inc., and therefore its successor DIA, to pay unconditionally any and all amounts due from Mulberry Partnership on the bonds, not just SPA's limited obligation.

Additionally, DIA as successor to Cecil B. Day Companies was not acting as a mere volunteer when it paid the principal and interest on the bonds after the default of the Debtor. C&S made demand upon CBD Enterprises, Inc., now DIA, for payment of the bond debt after Debtor's default. DIA promptly paid the amounts due. Cecil B. Day Companies and its successors were bound under the guaranty agreement to pay Mulberry Partnership's full bond debt, not just SPA's limited debt, and was not voluntarily paying Debtor's debt as an act of charity. *See generally* Matter of Bugos, 760 F.2d 731 (7th Cir. 1985) (A father jointly liable with his son on their home mortgage was not making a gift when he made mortgage payments on the son's behalf and was entitled to subrogation under Section 509(a)). DIA paid a debt of the Debtor under the guaranty agreement. Therefore, I conclude that DIA as successor to Cecil B. Day Companies is a guarantor of a claim

against the Debtor under Section 509.

B. Subrogation in Section 509 is separate from the equitable doctrine of subrogation and does not require full payment of the debt.

Although Section 509 of the Bankruptcy Code refers to subrogation, this Code section is separate and distinct from the established doctrine of equitable subrogation. *See* In re Spirtos, 103 B. R. 240, 243-245 (Bankr. C.D.Cal. 1989) (An insurer ineligible for co-debtor status under Section 509 may be entitled to subrogation under the principles of equitable subrogation); Section 509 is an additional but not exclusive remedy. In re Cooper, 83 B.R. 544, 546 (Bankr. C.D.Ill. 1988) (The right of a co-debtor under the Code to subrogate is a federally created right not based on state law). Contra; In re Kaiser Steel Corp., 89 B.R. 150 (Bankr. D.Colo. 1988) (A co-debtor must satisfy both the requirements of 11 U.S.C. Section 509 and the principles of equitable subrogation); In re Trasks' Charlois, 84 B.R. 646 (Bankr. D.S.D. 1988).

At least two circuit courts have discussed the subrogation issue to a limited extent in the bankruptcy context. Bank South cites In re New England Fish Co., 749 F.2d 1277 (9th Cir. 1984), in which the Ninth Circuit sets forth the requirements for equitable subrogation without referring to Section 509. Similarly, the Sixth Circuit in In re Glade Springs, 826 F.2d 440 (6th Cir. 1987) applied the doctrine of equitable subrogation without citing Section 509. These courts apparently applied equitable subrogation without applying the Bankruptcy Code provision for subrogation found in Section 509; therefore, these circuit court cases are not helpful in determining the application of Section 509.

Bank South argues that all of the requirements for equitable subrogation, including the requirement that the debt be paid in full, should be required under Section 509 as in Trasks and Kaiser Steel, supra. However, the better view is that Section 509 is separate and distinct from equitable subrogation and state law requirements for subrogation. *See* Spirtos and Cooper, supra. In Feldhahn v. Feldhahn, 929 F.2d 1351 (8th Cir. 1991), the Eighth Circuit recognized the distinction between Section 509 and the equitable subrogation principles. Although the Eighth Circuit concluded that the additional five-part test was satisfied in it left open the issue as to whether or not the five-part test must be met in all subrogation cases, including Section 509 cases. Additionally, the bankruptcy court in In re Valley Vue Joint Ventures, 123 B.R. 199, 203 n.7,12 (Bankr. E.D.Va. 1991) regards the five-part test as stated in Feldhahn and Kaiser to be too rigid for an equitable theory, implying that courts should be more flexible when applying the doctrine of equitable subrogation. Accordingly, I conclude that the five-part test in Kaiser, supra., does not have to be satisfied under Section 509.

The face of Section 509 clearly states that the paying party is "subrogated to the rights of the creditor to the extent of such payment." 11 U.S.C. §509(a) (emphasis added). This section does not contemplate that the debt must be paid in full before the payor is entitled to subrogation. In re Early & Daniel Industries, Inc., 104 B.R. 963 (Bankr. S.D.Ind. 1989). The payor is subrogated to all rights of the creditor to the extent of the payment. In re Cooper, 83 B.R. 544 (Bankr. C.D.Ill. 1988). *See* In re Chasey, 16 B.R. 347, 348 (Bankr. W.D.N.Y. 1982). According to the legislative history, to the extent that a claim is satisfied by a co-debtor or surety, the other creditors should not benefit by the surety's inability to file a claim against the estate merely because the co-debtor has failed to pay the

claim in full. *See* 124 Cong. Rec. H11094 (daily ed. Sept. 28, 1978); S17410-11 (daily ed. Oct. 6, 1978); remarks of Rep. Edwards and Sen. DeConcini; reprinted in 4 Norton Bankruptcy Law and Practice §502 (1991).

Subrogation for partial payment under Section 509 is a deviation from the equitable doctrine of subrogation applied in Trasks and Kaiser, which required full payment of the debt. As the origin of Section 509 is derived from the equitable principle of subrogation, some but not all of the requirements under Section 509 are the same as those required for equitable subrogation. For instance, under Section 509, the paying party must not be a volunteer and must not be primarily liable on the debt. *See generally* In re Valley Vue Joint Ventures, 123 B.R. 199, 203 n. 7,12 (Bankr. E.D.Va. 1991) (The party requesting subrogation should not be primarily liable on the debt satisfied). Nevertheless, Section 509 authorizes subrogation "to the extent of such payment" which evidences clear intent to ease the equitable subrogation requirement of full payment.

Additionally, Bank South argues that the Third Supplemental Indenture of Trust and Second Amendment to Deed to Secure Debt and Security Agreement entitles DIA to subrogation only if the entire bond debt is paid in full. That part of the mortgage, the amended sections 9.13 and 9.18, which are nearly identical in substance, provide in pertinent part as follows:

> If, following any default, Mulberry Partnership, Days Inns of America, Inc. (as general partner of Mulberry Partnership) or the Guarantor should pay to the Trustee, for the use and benefit of the Bondholders, the principal of all Outstanding Bonds and all interest accrued thereon, then, in such event, all such amounts so paid shall be

> deemed to be the indebtedness the repayment of which is secured by this Mortgage, and the Trustee shall assign and convey all of its right, title and interest in and to this mortgage to Mulberry Partnership, Days Inns of America, Inc., or Guarantor, as the case may be, shall be subrogated to all of Trustee's . . . rights, and shall have all remedies and powers of the Trustee . . .

See Page 2 of the Third Supplemental Indenture of Trust and Second Amendment to Deed to Secure Debt and Security Agreement. Bank South would have this Court construe the provision above to exclude subrogation for partial payment. The amendment refers only to subrogation upon full payment and does not mention subrogation upon partial payment. Under the doctrine of *inclusio unius est exclusio alterius*, Bank South argues that the parties intended to exclude subrogation for partial payment. I cannot conclude that this was the intent of the parties. Instead the section appears to clarify the rights of the remaining parties upon full payment to the bondholders and after the trustee is no longer needed. This section only provides for the rights of the parties upon full payment and does not restrict rights upon partial payment of the bond debt. In the absence of express contrary agreement, Section 509 allows subrogation to the extent of payment.

C. Subrogation applies to pre-petition and post-petition payments.

Section 509 may be used by DIA to subrogate to C&S's secured claim for both its pre-petition and post-petition payments. *See* Matter of Bugos, 760 F.2d 731 (7th Cir. 1985) (The principle of subrogation applies to the satisfaction of debts by a co-debtor prior to bankruptcy as well as to post-petition satisfaction of debts. *See* In re Sensor Systems, Inc., 79 B.R. 623 (Bankr. E.D.Pa. 1987).

Also, DIA has a choice between subrogation under Section 509 and a claim for reimbursement under Section 502(e). In re Early and Daniel Industries, Inc., 104 B.R. 963, 966 (Bankr. S.D.Ind. 1989). As subrogation entitles DIA to step into the shoes of C&S as a secured creditor, DIA has made the election to subrogate instead of opting for a mere unsecured claim for reimbursement under Section 502. Additionally, Section 509(c) requires the subrogated claim to be subordinated to the claim of the creditor. Id. at 967. In other words, the remaining claim of C&S, the creditor, must be paid in full before DIA, the subrogated party, may be paid.

II. DIA as Successor to the Guarantor and as General Partner of Mulberry Partnership.

DIA was potentially liable for the bond debt in two separate ways. First, DIA was successor to Cecil B. Day Companies, the original guarantor. Second, DIA was general partner of the Mulberry Partnership, the original obligor for the bond debt in the June 1, 1981, bond loan agreement.

Under the original guaranty agreement, Cecil B. Day Companies was to pay the amounts due on the bond loan if a default occurred. Bank South argues that "no demands ever were made on DIA in any capacity other than its capacity as a guarantor . . . " *See* Brief in support of Bank South N.A.'s Motion for Summary Judgment, page 27, filed August 21, 1991.

The two demand letters from C&S attached to the Collins Affidavit were addressed to James E. Cutler, Chief Financial Officer, CBD Enterprises, Inc., c/o DIA. *See* Exhibits 23 and 24. Also, the letters expressly state that demand was being made upon CBD

Enterprises, Inc., pursuant to Section 2.1 of the guaranty agreement. As argued by Bank South, the payment demands were made upon DIA as guarantor and successor to Cecil B. Day Companies, Inc., later CBD Enterprises, Inc. *See* Stipulation of Facts.

Completely separate from DIA's status as successor to the original guarantor is DIA's status as General Partner of the Mulberry Partnership. DIA was the General Partner of the Mulberry Partnership when the original bond loan agreement was signed.[9] Despite the sale of the Mulberry Inn property to Mulberry Inn, Inc., the Mulberry Partnership agreed to remain primarily liable for the bond loan. *See* Third Amendment to Loan Agreement dated February 1, 1985. The Debtor agreed to be primarily liable for the bond debt and assumed Mulberry Partnership's obligations under the bond loan agreement pursuant to the Assumption Agreement of June 30, 1988.

Bank South argues that Mulberry Partnership acquired the status of surety upon the sale of the Mulberry Inn property to Mulberry Inn, Inc. Bank South additionally argues that Mulberry Partnership was released as surety upon an increase in risk caused by the default of the subsequent purchasers and later foreclosure. However, Mulberry Partnership agreed to remain primarily liable for the bond debt. Mulberry Partnership consented to Mulberry Inn, Inc.'s operation of the inn and implicitly agreed to pay the bond

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[9] *See* O.C.G.A. Section 14-9A-70 which provides:

> A general partner [in a limited partnership] shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners . . .

See also Sugarman v. Shaginaw, 151 Ga. App. 621, 260 S.E.2d 731 (1979) (A general partner in a limited partnership has the same rights and liabilities of a partner in an ordinary partnership). Thus, a general partner in a limited partnership may be held generally and individually liable for partnership debts.

debt if it went into default while under new management. Indeed, Mulberry Inn, Inc., and its successor, Mulberry Inn, Ltd., defaulted in its obligations to Bank South, which acquired the property by a foreclosure. These events did not release Mulberry Partnership from its promise to remain liable for the bond debt.

After the foreclosure, Bank South sold the inn to the Debtor. When the Debtor purchased the property, it agreed to be "primarily liable" for the bond debt. *See* Assumption Agreement dated June 30, 1988. Mulberry Partnership did not separately agree to remain liable for the bond debt after Debtor's purchase; however, the parties have failed to show that Mulberry Partnership was released from the obligation and sale of the property at foreclosure is obviously a risk that Mulberry Partnership agreed to when it bound itself to remain liable on the debt after the sale which created the liability foreclosed upon. At the time of Debtor's assumption, Mulberry Partnership's status changed to that of a surety, although Mulberry Partnership was not released from the debt in any way. When a grantee assumes an indebtedness secured by the property purchased, between the grantee and grantor, the grantee becomes a principal and the grantor becomes a surety. Osborn v. Youmans, 219 Ga. 476, 481-82, 134 S.E.2d 22 (1963); Zellner v. Hall, 210 Ga. 504, 80 S.E.2d 787 (1954). Additionally, where the holder of the security deed obtains a new obligation running directly between himself and the new grantee, the grantee becomes the principal and in the absence of special conditions the holder of the security deed is bound to recognize the grantor, already liable on the deed, as surety. Zellner v. Hall, 210 Ga. at 505. The assent of the mortgagee of the assumption of the debt by a purchaser does not automatically release the original debtor from liability for the debt. Codner v. Siegel, 246 Ga. 368, 369 n.2, 271 S.E.2d 465 (1980). *See* Zellner v. Hall, 210 Ga. at 505. Thus, C&S

could demand payment from the Debtor or from Mulberry Partnership as surety. Bank South has failed to show that Mulberry Partnership has been released from its obligations for the bond debt.

Finding no issue of material fact regarding DIA's right to subrogation under Section 509, DIA's Motion for Summary Judgment is granted. While the Motion is denominated a Motion for Partial Summary Judgment the only issue DIA seeks to reserve is the question of its entitlement to attorney's fees under 11 U.S.C. Section 506(b). DIA may pursue its attorney's fees in the context of the underlying Chapter 11 case or under state law if the case is hereafter dismissed. My decision to grant DIA's Motion for Summary Judgment necessarily dictates denial of Bank South's Motion for Summary Judgment seeking a determination that the claim of Bank South has priority over that of DIA.

Accordingly, DIA is declared to be subrogated to the rights of Citizens and Southern Trust Company (Georgia), National Association ("C&S") to the extent of $944,071.76, together with interest and reasonable attorney's fees thereon and subject to the rights of C&S, DIA's claim is fully secured and superior to the lien of Bank South, N.A. DIA, as General Partner of Mulberry Partnership and as successor to the guarantor should be entitled to subrogation for the amounts it paid C&S on the bond loan debt.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of March, 1992.